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A 'very hard soft landing'? Fidelity's 2025 economic forecast
By Rob Burgess
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As 2025 begins, several questions hang in the air as the effects of the monumental changes of 2024 take shape.

Will the Federal Reserve continue its rate cuts as inflation slowly drops? How will the incoming Republican majorities in Washington shape fiscal policy? And how will the market react?

These were among the topics addressed during a Jan. 13 Fidelity Investments webinar on "2025 Markets & Economy Outlook."

Interest rates, inflation and a backdrop of government deficits
Jurrien Timmer, director of global macro at Fidelity, said at the end of 2023 there was a pivot where the Fed signaled it would cut rates three times in 2024, "which is exactly what it did."

Therefore Timmer said the 2024 market experienced "bullish broadening," where more stocks somewhat outperformed.

Regarding the Fed's goal of slowly lowering interest rates as inflation eases, Denise Chisholm, director of quantitative market strategy at Fidelity, said when she looks at the data, she and her team "struggle about the landing aspect."

"I either think we need to say we had a very hard soft landing, or we had a very soft hard landing," she said. "But either way, we landed."

Though inflation is currently just under 3%, a fraction of what it was when it hit a high of 9% in 2022, that downward progress has been somewhat stalled, said Dirk Hofschire, Fidelity's director of asset allocation research.

A current state of "disinflation" has taken hold, meaning that prices are rising at a slower rate, not necessarily coming down, he said.

Still, the Fed is expected to make additional interest rate cuts throughout 2025.

"We are seeing core inflation staying close to the 3% and not making any additional progress towards the Fed's 2% goal," he said. "The markets are starting to realize this is probably a sort of higher for longer challenge."

No matter what, Hofschire said, the markets are paying more attention to the size of deficits, the debt dynamic and the financing in the treasury markets.

"Our debt levels are so high," he said. "Interest payments are now taking up a much higher proportion of the budget. And they're growing, even if rates don't go up from here."

According to the Congressional Budget Office, interest expenses take up 16% of the overall U.S. budget, while defense spending takes up 12% and discretionary spending is at 10%.

"It's difficult to imagine cutting the budget enough if you're not going to touch any defense in any significant way," he said. "This is a challenging backdrop."

Some policy changes will take longer to implement than others

Hofschire said that while 2024 was a year of politics, 2025 has the potential to be a year of policy.

"Anytime you make major changes in spending taxes, that'll matter," he said.

Looking at possible policy changes promised by President-elect Donald Trump on the campaign trail, Hofschire said some will take much longer to come to fruition, while others will have more of an immediate effect.

Policies like a regulatory freeze, targeted tariffs and tighter border security could be implemented quickly.

Meanwhile, goals like lowering corporate and personal tax rates, implementing broad tariffs and starting mass deportations would take more time and have a greater impact on growth and inflation.

Among the legislative priorities in the new Republican Congress will be extensions of aspects of the 2017 Tax Cuts and Jobs Act, which could add $4.6 trillion to the debt outlook over the next decade.

The increased tariff rates, especially those on China, would have a detrimental effect on inflation rates due to the resulting higher consumer prices in the U.S., Hofschire said.

"A lot of this stuff is going to take months and months to be, first debated, but then implemented," he said.